

Congress of the United States
House of Representatives
Washington, DC 20515-4906
September 22, 2004

Student Loans and Accounting 101

Don't get fooled by this sleight of hand...

Dear Colleague,

Government budget analysts have consistently found that the taxpayer costs for student loans provided through the Direct Loan program (DL) are significantly lower than those under the Federal Family Education Loan program (FFEL), the federal government's other student loan program. Some members of the student loan industry, however, say just the opposite. Here are some examples from loan industry briefing papers:

"Last year the FFEL program carried no cash cost to the government."

"On a cash basis, the federal government has spent more each year on DL than it has spent on FFEL."

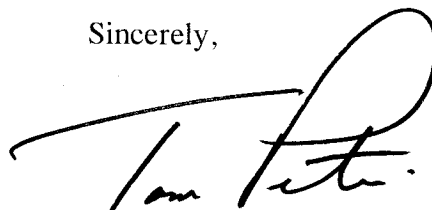
How does the loan industry reach these conclusions? Easy. They use a different accounting method... one deemed inaccurate by government accounting experts. **The student loan industry's accounting method of choice, called cash accounting, is actually meaningless with respect to the real long-term costs of student loans**, or any type of loan for that matter. Both the GAO and the Federal Accounting Standards Advisory Board have said as much.

The problem with cash accounting is that costs are booked only as they occur. That means loan guarantees and future subsidies promised to private lenders under the FFEL program aren't shown. But there's an even bigger distortion under cash accounting: Direct Loans are treated as grants. In other words, the full value of a Direct Loan appears to be money spent the year it is made, even though it will be paid back with interest over time. Put these two distortions together and cash accounting can make Direct Loans look very expensive and FFEL loans look cheap, especially in certain years. No wonder it's the accounting method of choice for the student loan industry.

The bottom line is that when all of the costs are considered — through long-term accounting — federal budget agencies show Direct Loans to be much cheaper than FFEL loans. I have introduced bipartisan legislation, the Direct Loan Reward Act (H.R. 4370), that would encourage more schools to use Direct Loans. In return, students at those schools would receive as grant aid a portion of the program's savings. In other words, students could receive the subsidies that would have gone to private lenders had their school used the FFEL program. Student aid would increase at no additional cost to taxpayers.

For more information on student loan costs, or to cosponsor the Direct Loan Reward Act, please contact Jason Delisle of my staff at 5-2476.

Sincerely,



Thomas E. Petri
Member of Congress